Equity Markets - Timing the Market or Time in the Market

CA. Vinit Sambre

The author is a member of the ICAI and Head, Equities, DSP Mutual Fund. He can be reached at vinit.sambre@dspim.com or eboard@icai.in

Indian economy is currently facing a slowdown. GDP growth in FY19 slumped to a five-year low of 6.8% and the fourth quarter of FY19 showed that the economy grew at 5.8%. With this, India has slipped one notch in the World Bank's GDP ranking in 2018 and is now the 7th largest economy. In 2017, India had overtaken France as the 6th largest economy. There could be various reasons attributed to the current slowdown right from some of the adverse international developments like US-China trade war tension which is causing slowdown globally, currency volatility, fall in global yields indicating recessionary trends, and few India specific factors. These include the liquidity crunch started due to IL&FS fiasco (and now ensnaring other NBFCs), rising unemployment rate as some of the core sectors like Construction (especially Real Estate), Automobile, etc. facing continuous slowdown, higher taxation structure adversely impacting disposable incomes and poor farm economics leading to low income generation amongst the farmers. The equity capital markets have borne the brunt of these adverse developments. Read on…

Towards the end of July 2019 and beginning of August 2019, India's stock market capitalisation fell below the US$ 2 trillion mark, triggered by the selloff in July that led to almost about 9% erosion in investors' wealth. India's total value of all listed stock dropped to US$ 1.97 trillion on 2nd August 2019, slipping below Europe's biggest economy – Germany - as foreign investor sentiments took a beating following the increase in tax surcharge for many of them and slowdown in the economy.

The most important issue currently faced by the Indian equity investor, be it through direct investment into equities or through equity mutual funds, is what should be the strategy going forward.

Just to put things into perspective, we have plotted the annualised returns of equities for two different time periods in Annexure I. The 1st series of data pertains to the annualised returns as on 31st August 2018 when the markets were near its all-time highs and another set as of now i.e. 31st July 2019. We have taken into consideration three different indices viz. large cap index represented by Nifty 50, Mid-cap index represented by Nifty Midcap 100 index and Small cap index represented by

S&P BSE Small Cap index.

As can be seen from the Annexure I below, as on 31st August 2018, the Nifty 50 on a 5 year basis delivered an annualised return of 16.4% which is now down to 7.6% as on 31st July 2019. Similarly the mid-cap index returns have also scaled down considerably from 24.7% to 8.0% in the same period and small caps have fared more poorly with returns falling from as high as 27.0% to 4.9%. On a 1 year basis, the scenario is bleaker especially on the small and mid-cap front. For example the 1 year return for the small cap index is down from 7.5% to -23.0%.

Annexure I

Annualised Returns

As on 31st August 2018	5 Yr	3 Yr	1 Yr
Nifty 50	16.4%	13.6%	17.8%
Nifty Mid Cap 100	24.7%	15.1%	9.0%
S&P BSE Small Cap	27.0%	16.1%	7.5%
As on 31st July 2019	**5 Yr**	**3 Yr**	**1 Yr**
Nifty 50	7.6%	8.8%	-2%
Nifty Mid Cap 100	8.0%	2.5%	-16%
S&P BSE Small Cap	4.9%	1.0%	-23%

Source-Internal

While the S&P BSE Small cap index has fallen by about 23% on a 1 year basis almost about 249 stocks accounting for 29% of the index have fallen by more than 50% in the last 1 year and the worst performing 30 stocks have fallen more than 80% eroding significant wealth of the investors who might have invested in these stocks.

Another interesting data which is seen from the Annexure II below is that two consecutive negative years in mid-caps have not occurred previously. Also the mid cap index bounces back noticeably after every year of a fall. This may be the historical trend which could be used just as an indicator and might not repeat every time as is the case in 2018 and year to date in 2019.

But certainly, every fall presents an opportunity to buy something at cheaper valuations, thereby improving the chances of future return, provided the companies one buys has inherent value and current prices have fallen enough in consideration to its inherent value. Most mistakes often committed by the investors is in judging this inherent value, which leads to sub-par outcomes.

Annexure II

Nifty Mid Cap 100		
Year	Current yr Return	Next 1-yr Return
2001	-30%	24%
2002	24%	138%
2003	138%	25%
2004	25%	35%
2005	35%	29%
2006	29%	77%
2007	77%	-59%
2008	-59%	99%
2009	99%	19%
2010	19%	-31%
2011	-31%	39%
2012	39%	-5%
2013	-5%	56%
2014	56%	6%
2015	6%	7%
2016	7%	47%
2017	47%	-15%
2018	-15%	-12%
2019	-12%	

Source – Goldman Sachs Research

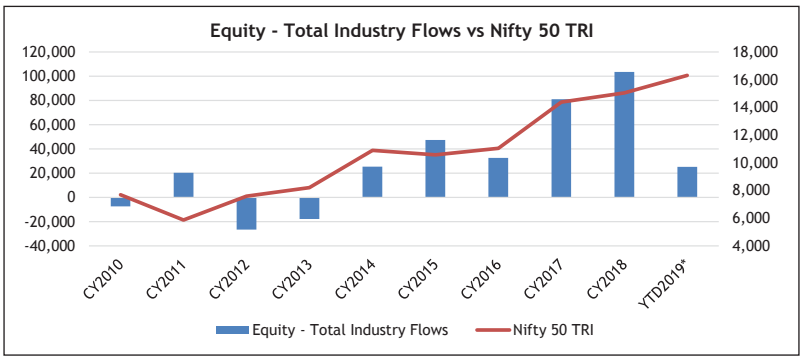
The current situation is not something new and we have witnessed such down periods in the past as well like in 2001, 2008, 2011 etc. It is practically not possible for many to predict and prepare for the ensuing downturn because the gains preceding the downturn typically are so attractive that investors fail to acknowledge the rising risk with rising prices and are rather tempted to allocate more as the price goes up. Past returns become the benchmark for allocating higher sums to equities.

For example, in 2000, just before the tech bubble burst, we had seen how investors had flocked to the Technology sector which had assumed a significant proportion of many portfolios. The stocks were trading at crazy multiples of over 100 X Price / Earnings ratio. Most of these investors paid a heavy price when the tech bubble bust in 2001. Similarly, in the 2004-2007 rally many investors had flocked to the infrastructure sector and lost heavily in the period thereafter. Back then, there were so many renowned companies which were darlings of investors.

Some of them are facing near bankruptcy situation today/or have just vanished. Similarly in the 2014-2017 period, the small and mid-caps became the new craze and significant money got allocated to this category. We at DSP Mutual Fund were running one of the most successful funds in this category where and we witnessed significant proportion of our total firms inflow during 2014-2017 coming into this fund. Recognising the rising risk, we took a call in 2017, well ahead of the steep fall in the category, to stop taking any inflows into the fund. This was also an indication to the investors about the rising risk in the category. As seen from above, we are already facing a massive correction in this category of stocks leaving investors high and dry.

Investors ignore the basic fundamental principle of intrinsic value versus the price and which is where we said that the outcomes become sub-par. In the Annexure III we have carried out an analysis showing the correlation of past returns and inflow of money in domestic equity mutual fund. As can be seen investors use the past returns as benchmark to allocate more and in the process increase their risk by buying at higher valuation.

Annexure III



Source – Internal

The equity markets by their very nature are volatile and will remain so. We cannot change that but we can definitely change our behavior and temperament which is more important for generating returns. Again as an example, one of our oldest funds which is in existence for 22 years have generated an annualised return of over 19%, which means money growing 50 times over for someone who remained invested since beginning of the fund. As good as it may sound; it is unfortunate to mention that only 141 investors of the total 119456 investors now continued to remain with the fund since beginning to see this gain. Many switched in and out of it probably looking at the short term volatility or underperformance. The virtue of patience cannot be amplified much better than this example as for those who stayed put for the last 20 years would have witnessed this eighth wonder of the world – COMPOUNDING. Hence it is the time in the market rather than timing the market which is of crucial importance.

Way forward

Just like few times in the past, today's environment looks equally challenging. Investors, which particularly came in the market in the last 2-3 years, are facing worst outcomes currently and are stressed. I am sure an economy which boasts of so much of entrepreneurial spirit, rich demographic dividend, rising incomes and improved spending power supported by low interest rates and benign crude oil price environment, low inflation, etc. will come out of this slumber sooner or later. We have the right ingredients to revert to our position of being the fastest growing economy in the world. Some initiatives by the government to restore confidence and boost growth are required to accelerate the process, which we believe the government is actively looking into.

Given the current uncertainty, it is likely that markets may continue to remain subdued and in corrective mode. However, it is in this uncertain environment the chances of finding bargains would go up as well. This is provided the investments are restricted to companies where investors understand the interplay between the intrinsic value and market price. This market, like many times in the past would reward investors who will demonstrate the ability to digest the near term volatility, invest with long term view and manage one's temperament well. The world's greatest investor Warren Buffett has very aptly captured the essence of this in his saying, **"It is wise to be fearful when others are greedy and be greedy when others are fearful."** ■

Note: Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. There is no guarantee of returns/ income generation in any Scheme. Further, there is no assurance of any capital protection/capital guarantee to the investors in any Scheme.

Best friends are like stars?. You don't always see them, but you know they are always there. *- Anonymous*